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Theoretical perspectives on corporate disclosure: a critical evaluation and literature survey

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Abstract

Purpose – The purpose of this paper is to provide an extensive and critical overview of the theoretical perspectives used in the accounting disclosure literature including economic theories, political and social theories.

Design/methodology/approach – The paper reviews and discusses in details the positive accounting theory (PAT), agency theory, signalling theory, political economy theory (PET), stakeholder theory, legitimacy theory and contingency theory to identify the situations suit each of these perspectives.

Findings – The main finding shows that there is no universal theory applicable for all situations or societies. For example, PAT is probably used when a corporation believes that its primary responsibility is to use its resources and engage in activities designed to maximise its profits. On the other hand, the PET seems to better explain why some corporations appear to respond to government or public pressure for information about their social impact. The agency theory provides the required framework to evaluate accounting choices and disclosure decisions in market-based studies. While the legitimacy theory seems to be more suitable for multinational corporations working in developed/democratic countries, the stakeholder theory seems to be most suitable for multinational corporations working in developing/dictator countries; whereas a corporation can manage its stakeholders. The contingency theory supports our main finding that different theories are required for different situations, as it clearly indicates that management's preferences of reporting practices are related to the nature of environmental and organisational constraints rather than their relative income effects.

Originality/value – The paper contributes to the limited body of literature concerning the accounting disclosure theories and to identify the main theoretical perspective that can be used in the accounting disclosure research.

Keywords Stakeholder theory, Legitimacy theory, Contingency theory, Political economy theory, Accounting disclosure practice, Positive accounting theory

Paper type Literature review

1. Introduction

According to Healy and Palepu (2001), financial reporting and disclosure are potentially important means for management to communicate firm performance and governance to outside investors. During the past three decades, empirical researchers have investigated accounting disclosure practices and explained the rationales for such practices using several theoretical perspectives (Lopes and Rodrigues, 2007). Gray *et al.* (1995a, p. 50) provide a useful categorisation of theoretical perspectives adopted in the

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existing literature. They identify three principal categories of theories being decision-usefulness theories, economic theories including positive accounting theory (PAT) and political and social theories. First, studies using decision-usefulness theories ask participants to rank items in terms of their importance, such as asking investors to rank the type of information they would like to be included in the annual report in order of importance (Epstein and Freedman, 1994). Other decision-usefulness studies attempt to determine whether social responsibility information has an information value to financial markets or participants (Gray *et al.*, 1995b). One example is the study undertaken by Shane and Spicer (1983) that analysed changes in security market returns following the public release of environmental performance ratings.

Archambault and Archambault (2003) find that disclosure is influenced by factors from a broad range of social systems: cultural, political, economic and corporate. The signs and/or significance of several individual factors changed with model specification, however. This implies that further investigation of disclosure determinants requires control of a variety of factors and further model development to clarify understanding of the influence of these factors on disclosure. Their model shows that factors in each system (culture, national and corporate systems) can influence the level of corporate financial disclosure through their actions. Moreover, they find strong relationships between disclosure and the cultural and national systems that indicate the acceptance of mandated disclosures from a body such as the IASC may be met with resistance. Therefore, theories related to corporate disclosure that are commonly used through the literature include PAT, agency theory, signalling theory, PETs, stakeholder theory, legitimacy theory and contingency theory.

The rest of the paper is constructed as follows. Section 1 provides an overview of the PAT, agency theory and signalling theory. Political economy theory (PET) will be discussed in Section 2. An overview of stakeholder theory will be provided in Section 3. Legitimacy theory will be covered in Section 4. Contingency theory is discussed in Section 5. Finally, Section 6 provides the conclusion and summary of the paper.

2. PAT, agency theory and signalling theory

Accounting research prior to the mid-1960s was mainly normative, seeking to prescribe "what should be" or "what ought to be" in relation to accounting measurement and financial reporting. As normative accounting research did not seek to empirically explain accounting practice, positive accounting research developed to overcome this limitation. Indeed, modern positive accounting research began to flourish when Ball and Brown (1968), Beaver (1968), and others started applying empirical finance methods to financial accounting (Watts and Zimmerman, 1990, p. 132). However, earlier positive researchers just investigated the "information perspective" of accounting information based on finance theory underlying the empirical relationship between accounting numbers and stock prices (Watts and Zimmerman, 1990). But since the "information perspective" assumes only the market's use of accounting data (i.e. how investors use accounting information in reacting to stock prices), this perspective provides only a partial view of a theory, ignoring managers' intentions to provide information. In the 1970s and 1980s, accounting and finance academics, such as Jensen and Meckling (1976), and Watts and Zimmerman (1978, 1979, 1986, 1990) endeavoured to fill this research gap by incorporating an explanation of the "opportunistic perspective" of accounting information. Managers' use of accounting choices based on the nexus of contracts (interest, decisions and actions) between agents and principals is the main concern of this perspective.

The issue of opportunistic use of accounting choices is discussed in detail in Jensen and Meckling's "agency theory" and Watts and Zimmerman's "PAT". Although both of these theories have been extensively used in accounting research, neither is free from criticism.

PAT

PAT analyses "what is" as opposed to the normative theory approach, which analyses "what should be" (Deegan, 2013). Watts and Zimmerman (1986, p. 7) define PAT as being concerned with explaining accounting practice. It is designed to explain and predict which firms will and which firms will not use a particular accounting method. PAT is based on the wealth maximisation and individual self-interest concepts underlying economic theory (Gray *et al.*, 1995a). As such, it is consistent with the argument that the primary responsibility of the corporation is to use its resources and engage in activities designed to increase its profits (Watts and Zimmerman, 1986, 1990). A typical utilisation of PAT explains movements towards socially or environmentally responsible behaviour and/or disclosure as being a result of market forces that direct the self-interest of the entrepreneur into socially useful channels (Deegan, 2013). While it would be unrealistic to ignore the presence of this behaviour, relying upon self-interest and expectations of wealth maximization as the main or sole motivation for corporate environmental disclosures has been criticised (Gray *et al.*, 1995b). Social and political factors also affect upon the corporation. Corporations operate within an environment of many constituents, often with conflicting aims and objectives (Watts and Zimmerman, 1979; Oliver, 1991). It is also noted that the sole responsibility of corporations is no longer perceived to be economic-performance based (Patten, 1992; Epstein and Freedman, 1994; Lothian, 1994; Beaver, 2002).

Jensen and Meckling (1976) assume that managers utilise choices to select and use information, but do not provide a detailed explanation of the nature of accounting methods (choices). This is better articulated in the PAT of Watts and Zimmerman (1986, 1990). In the domain of *agency theory*, agency costs (monitoring costs, bonding costs and the residual loss) are the contracting costs determining selection of managers' choices. By comparison, the scope of contracting costs in Watts and Zimmerman's PAT is more expansive. As explained by Watts and Zimmerman (1990, pp. 134-135):

> Contracting costs consist of transaction costs (e.g. brokerage fees), agency costs (monitoring costs, bonding costs, and the residual loss from dysfunctional decisions), information costs (e.g. the costs of becoming informed), renegotiation costs (e.g. the costs of rewriting existing contracts because the extant contract is made obsolete by some unforeseen event), and bankruptcy costs (e.g. the legal costs of bankruptcy and the costs of dysfunctional decisions).

The major focus of agency theory has been on managers' incentives (stock options, bonuses and other perquisites) to make accounting choices (without identifying the accounting methods) in their favour unless their interests, decisions and actions are constrained by internal control and external audit. By contrast, three sets of variables (bonus plan hypothesis, debt-equity hypothesis and political cost hypothesis) are considered in PAT (Watts and Zimmerman, 1990, pp. 138-139):

> The bonus plan hypothesis is that managers of firms with bonus plans (tied to reported income) are more likely to use accounting methods that increase current period reported income […] The choice studies to date find results generally consistent with the bonus plan hypothesis. The debt-equity hypothesis predicts (that) the higher the firm's debt/equity ratio,

> the more likely managers use accounting methods that increase income. The higher the debt/equity ratio, the closer (i.e. tighter) the firm is to the constraints in the debt covenants […] Managers exercising discretion by choosing income increasing accounting methods relax debt constraints and reduce the costs of technical default. The political cost hypothesis predicts (that) large firms rather than small firms are more likely to use accounting choices that reduce reported profits.

Given the cost of information and monitoring, managers have incentive to exercise discretion over accounting profits and the parties in the political process settle for a rational amount of ex-post opportunism. Each hypothesis similarly posits that managers apply their idiosyncratic accounting discretion. The bonus plan and the debt/equity hypotheses are linked to increasing earnings. Under the political cost hypothesis, managers defer reported income from current to future periods to convince various public watch-dogs that managers are not generating excessive profits for firms' owners (Gaffikin, 2008). According to Gaffikin (2007, p. 9), agency theory is an important part of PAT. It has its origins in the information economics literature in which information is placed into an explicit decision-making setting. That is greater information leads to better decisions. However, agency theory extends traditional information economics in that it recognises that several forces are at play in organisations that affect how it operates. For example, the notion of information asymmetry is a problem that impacts on resource allocation issues. There is information asymmetry when some parties (managers) have greater information than others (e.g. investors). Therefore will manger disclose this additional information to the "market"? Agency theorists believe there has to be incentives for managers to make additional (voluntary) disclosures.

The assumptions underlying Watts and Zimmerman's PAT have been subject to significant academic scrutiny and review (e.g. see Tinker *et al.*, 1982; Christenson, 1983; Whittington, 1987). This theory predominantly focuses on the opportunistic perspective which considers self-interest and manipulative objectives of managers as the basis for at least two hypotheses – the bonus plan and debt/equity hypotheses. While the political cost hypothesis' modus operandi is to bias outsiders' perceptions of company performance, reduce taxes and uphold the reputation of managers. The best examples of this are that managers can reduce earnings in the current year using big bath accounting or cookie jar reserves, to increase prospective earnings and incentives in future years (Dechow and Skinner, 2000; McAnally *et al.*, 2008). While the opportunistic perspective constructs the basic premise of PAT, there are arguments that managers sometimes can provide information under the efficiency perspective[1].

Further, at a more abstract level, a vigorous theoretical debate continues about whether PAT actually constitutes a theory or is merely a methodology of positive research. The counter-argument to those scholars disputing its status is that (positive) accounting theory is in fact scientific (Watts and Zimmerman, 1986; Watts, 1995; Zimmerman, 2002) and so is therefore quite properly classified as positivist (Gaffikin, 2008). But because mainstream accounting researchers use positivist (deductive) research methodology, they cannot provide a social-constructive (inductive) interpretation of accounting phenomena (Mouck, 2004). Consequently, mainstream accounting researchers who depend on PAT do not provide an all-inclusive interpretation of accounting manipulation. Their studies mostly conduct statistical analyses of the link between earnings manipulation and selected factors (e.g. managerial incentives) based on large data sets. The attitudes (behaviour, verbalisation or justification) of managers after manipulation are ignored in this theory. The non-disinterested, real-world orientation and "capture" of positive accounting academic researchers in exploring the multiple realities relating to opportunistic financial reporting, is also noteworthy. Academic interests and managerial opportunism arguably coincided in the development and use of this theory and publication of positive research in the top ranked academic accounting and finance journals (Mouck, 2004; Parker, 2005, 2008; Gaffikin, 2008). It is considered that positive accounting research occurred in response to sponsorships[2] from large corporations. Many positivist researchers hold accounting chairs sponsored by major companies or accounting firms. It may be asserted that due to their industry capture, these researchers are unable to holistically explain their sponsors' self-interested behaviour, the mechanisms deployed to manipulate accounting information and the accompanying rationalising mentality. The exponents of positive research have also rhetorically asserted that the approach (positive theory) they follow is the sole, proper way to conduct accounting practice research (Beaver, 2002; Mouck, 2004; Gaffikin, 2007, 2008).

Signalling theory

This explains why firms have an incentive to report information voluntarily to the capital market: voluntary disclosure is necessary in order for firms to compete successfully in the market for risk capital. Insiders know more about a company and its future prospects than investors do; therefore, investors will protect themselves by offering a lower price for the company. However, the value of the company can be increased if the firm voluntarily reports (signals) private information about itself that is credible and reduces outsider uncertainty (Connelly *et al.*, 2011). Signalling theory is useful for describing behaviour when two parties (individuals or organisations) have access to different information. Typically, one party, the sender, must choose whether and how to communicate (or signal) that information, and the other party, the receiver, must choose how to interpret the signal. Accordingly, signalling theory holds a prominent position in a variety of management literatures, including strategic management, entrepreneurship and human resource management (Connelly *et al.*, 2011).

Although the signalling theory was originally developed to clarify the information asymmetry in the labour market (Spence, 1973), it has been used to explain voluntary disclosure in corporate reporting (Ross, 1977). As a result of the information asymmetry problem, companies signal certain information to investors to show that they are better than other companies in the market for the purpose of attracting investments and enhancing a favourable reputation (Verrecchia, 1983). Voluntary disclosure is one of the signaling means, where companies would disclose more information than the mandatory ones required by laws and regulations in order to signal that they are better (Campbell *et al.*, 2001).

Using the example of the creation of corporate environmental reputation, Toms (2002) offers a theoretical extension of the resource-based view of the firm to include quality signalling via the channel of accounting disclosure. Toms's proposed framework is then tested via an empirical survey into the relationship between environmental disclosure and environmental reputation. The results suggest that implementation, monitoring and disclosure of environmental policies and their disclosure in annual reports contribute significantly to the creation of environmental reputation. Diverse institutional share ownership and low systematic risk are also associated with positive environmental reputation. Prior financial performance has no impact and there is no evidence that environmental reputation is created by a financial halo effect or by the availability of slack financial resources (Toms, 2002).

Complementing and extending the work of Toms (2002), Hasseldine *et al.* (2005) integrate quality-signalling theory and the resource-based view of the firm to test the differential effects of the quantity and quality of environmental disclosures on the firm's environmental reputation. Hasseldine *et al.* (2005) use a quality-adjusted method of content analysis, so that sentences are not merely counted but also weighted to reflect their likely significance. Investments in research and development and diversification, as potential methods of enhancing of environmental reputation, are also considered. The results confirm the framework and models tested in Toms (2002) on more recent data and also suggest that quality of environmental disclosure rather than mere quantity has a stronger effect on the creation of environmental reputation amongst executive and investor stakeholder groups. Research and development expenditure, and under certain circumstances, diversification, also add to reputation. On the basis of signalling theory, Bin and Jing (2009) examine why listed companies in China voluntarily disclose the auditor's internal control reports. The samples of their study are selected from 13 potential pollution industries which have shares listed on the Taiwan Stock Exchange from 2001 to 2002. Using the Ohlson (1995) valuation model to test the value relevance of the environmental disclosures, and then the relation between environmental disclosures and market value of firms was explored by regression models. They find that in order to transmit the signal of their real value, firms which have more resources available for internal control, grow rapidly and have set up internal audit departments are more likely to disclose the reports. Conversely, those non-disclosers are older, in worse financial condition, under restructuring or violating rules. The sensitivity test using listed companies' internal control disclosure index supports our conclusions. Additionally, we find that firms tend to disclose the reports when they have SEO plans.

While the use of signalling theory has gained momentum in recent years, its central tenets have become blurred as it has been applied to organisational concerns. Connelly *et al.* (2011), therefore, provide a concise synthesis of the theory and its key concepts, review its use in the management literature, and put forward directions for future research that will encourage scholars to use signalling theory in new ways and to develop more complex formulations and nuanced variations of the theory.

The epistemological foundation of PAT is empiricism – that all knowledge is derived from sensory experience (Gaffikin, 2007). There are problems with a purely empirical epistemology and it has generally been rejected by philosophers of science. Christenson (1983) describes some of the problems. Knowledge cannot be derived from pure empiricism as it will have to be described in a language and use concepts which must be a priori. However, the most significant practical problem is the problem of induction. This is the belief in the uniformity of nature (phenomena) and is based on past observations. In other words, an inductivist argues that he or she will be able to make predictions based on knowledge derived from past observations. This presumes things remain the same such that the past observations are a guide to the unobserved things in the past and the future but the presumption is only based on (past) observed phenomena. Hence the reasoning is circular, we justify reliance on induction by relying on induction.

Consequently, the application of many economic theories, including PAT in the discussion of corporate social and environmental behaviour and disclosure, has been described as not empirically implausible (Gray *et al.*, 1995a, p. 52). The criticisms directed to economics-based theories, including PAT have resulted in the increased popularity of political and social theories in the social and environmental disclosure literature (Gray *et al.*, 1995a, b). These theories have become increasingly established over the recent years. Consequently, political economy perspectives including stakeholder theory and, largely, legitimacy theory have emerged as the dominant theoretical perspectives in the disclosure literature.

Although, PAT had grown as one of the most significant accounting research programme, the broad theories of accounting included interpretive and normative theories as well (Sharma, 2013).

3. PET

The concept of "political economy" is described as "the social, political and economic framework within which human life takes place" (Gray *et al.*, 1997, p. 47). Therefore, political economy concerns the varying levels of expectations (interest), accountability and achievements attached to different groups (in an economy or society) which influence others or are influenced by others where they are all in a competitive political process to achieve certain goals (Archambault and Archambault, 2003). As accounting regulations determine the domain (framework) of financial reporting, the development and implementation phases of accounting regulations reflect expectations, accountability, influence and achievements (equal or unequal) of various interest groups. This section focuses on disparate theories relating to the political economy of accounting regulation. There are a number of PETs of regulation. The most prominent theories are public interest theory, capture theory and private interest theory (Godfrey *et al.*, 2010). The fundamental assumption underlying these theories is that an expectation gap is created when different groups potentially affected by regulation, abandon stewardship or legitimising roles to maximise their own individual utility (Deegan, 2013).

The usefulness of PETs is that they do not focus solely on the economic self-interest and wealth maximisation of the individual or corporation. Instead PET considers the political, social and institutional framework within which the economy takes place. Several empirical studies have identified an increase of social and environmental annual report disclosures that correspond with periods where those issues peaked in importance politically and/or socially (Hogner, 1982; Guthrie and Parker, 1989). As such, PETs seem to better explain why corporations appear to respond to government or public pressure for information about their social impact (Guthrie and Parker, 1990, p. 172).

Furthermore, the importance of PET lies not only in its assessment of corporate disclosures as a reaction to the existing demands of stakeholders but in the way it perceives accounting reports as social, political and economic documents (Guthrie and Parker, 1990, p. 166). Consequently, PET also recognises the use of social and environmental disclosures in annual reports as a strategic tool in achieving organisational goals, and in manipulating the attitudes of external stakeholders (Guthrie and Parker, 1990).

In another study, Gray *et al.* (1997) classify PET into classical and bourgeois streams. Classical PET is linked to the works of Marx and the existence of class interest, power and conflict within society (Gray *et al.*, 1997). Alternatively, Deegan (2013, p. 252) describes classical PET as:

> Tending to perceive accounting reports and disclosures as a means of maintaining the favoured position of those who control scarce resources (capital), and as a means of undermining the position of those without scarce capital. It focuses on the structural conflicts within society.

Furthermore, Tinker and Niemark (1987, p. 72) use the classical PET to examine the use of annual reports within a capitalist society. They argue that, "corporate reports are not passive describers of an objective reality, but play a part in forming the world-view or social ideology that fashions and legitimises the company annual reports were deployed as ideological weapons aimed at influencing the distribution of income and wealth, in order to ensure the company continued profitability and growth".

On the contrary, the bourgeois political economy approach generally ignores sectional (class) interests, structural inequity, conflict and the role of the state and is content to perceive the world as essentially pluralistic (Gray *et al.*, 1995a, p. 53). The pluralistic view adopted by the bourgeois PET ignores the existence of particularly powerful groups in society but tends to focus on the group interactions within society as a whole (Gray *et al.*, 1997). The application of stakeholder and legitimacy theory in the accounting disclosure literature has been described as generally being within a bourgeois political economy perspective (Gray *et al.*, 1995a, b; Deegan *et al.*, 2000).

Public interest theory

This theory holds that regulation is a public good that benefits society (Posner, 1974). Government intervention is necessary to create a regulated reporting environment, with the objective of ensuring that accurate accounting information about firms is supplied to the market. This increases investor confidence in individual firms and improves overall market efficiency as a whole. Following various high-profile cases of accounting manipulation and corporate collapses in the first years of the 2000s, the Sarbanes-Oxley Act of 2002 in the USA, the Corporate Law Economic Reform Program (CLERP) 9 Act of 2004 in Australia and the mandatory application of accounting standards in Europe and Australia are viewed as public interest regulatory responses. Also, the Financial Reporting Council in Australia and the Public Company Accounting Oversight Board (PCAOB) in the USA have specific objectives and roles to serve the public interest. While public interest theory considers the normative or stewardship role of regulators, it ignores the opportunistic roles of regulators, capture of the regulatory process by regulates and the private interests of other stakeholders. Furthermore, the possible lack of competence by regulators and their being disinclined to protect the public interest may reduce the potential efficacy of this theory (Gaffikin, 2008).

The capture theory

This theory challenges the assumptions of public interest theory. As accounting numbers are influenced by accounting standards, various actors may strive to maximise their own interests by lobbying the standards-setting process (Zeff, 2002; Hill *et al.*, 2002). The standard setting process in Australia has seen the powerful presence, preferences and lobbying by the elite accounting profession and former executives from large companies (Walker, 1987). Craig and Clarke (1993) argue that Australian standard setting was characterised by capture, control, co-existence and coercion. The international accounting standard setting process, while ostensibly open and transparent, also has the potential of being captured by powerful interest groups (Cortese *et al.*, 2009). The International Accounting Standards Board (IASB) at present consists of members from the large accounting firms, executives from multinational firms and a few mainstream accounting academics.

A limitation of capture theory is its preoccupation with influence and preferences of those groups with the voting rights necessary to directly influence the standard setting process. In practice, non-members including professional accounting bodies, big accounting firms and executives from multinational companies without voting rights can also comment on exposure drafts (Tutticci *et al.*, 1994; Jupe, 2000). To overcome the limitations of both public interest theory and capture theory, the assumptions of private interest theory on the basis of suggestions of Stigler (1971) and Posner (1974) allows a more comprehensive understanding of the economic theory of regulation. According to this theory, numerous private interest groups are (in) directly involved in the development and implementation of accounting regulation, all of which are self-utility maximisers.

4. Stakeholder theory

Stakeholder theory asserts that the corporation's continued existence requires the support of the stakeholders, their approval must be sought and the activities of the corporation should be adjusted to gain that approval. The more powerful the stakeholders, the more the company must adapt (Gray *et al.*, 1995a). Literally, the definition of stakeholder has altered substantially over the past four decades. At one end of the spectrum, the shareholder was considered the sole or principal stakeholder. This definition is based on arguments proposed by Friedman (1962) that the corporation's foremost objective is to maximise the wealth of its owners (Friedman, 1962). However, Freeman (1984) expands the definition of stakeholder to include a broader selection of constituents including adversarial groups such as interest groups and regulators. Both the narrow (shareholder) and the expanded definition of stakeholders have been adopted in the development of mandatory disclosure regulations for corporations (Roberts, 1992).

According to Deegan *et al.* (2000), stakeholders have the ability to affect (directly or indirectly) the control of resources required by the corporation. Thus, stakeholder power is determined by the level of control they have over the resources. The stakeholder-corporation power relationship is not generic across corporations (Deegan *et al.*, 2000). According to Ullmann (1985, p. 552), power may take the form of command of limited resources (finances, labour), access to influential media, ability to legislate against the company or ability to influence the consumption of the organisation's goods and services. Therefore, when stakeholders control resources critical to the organisation, the company is likely to respond in a way that satisfies the demands of the stakeholders. Furthermore, Ullmann (1985) argues that organisations select the stakeholders that they want/need to consider, and the actions that they will take to achieve the desired relationship with those stakeholders.

Stakeholder theory is generally concerned with the way that an organisation manages its stakeholders (Gray *et al.*, 1997, p. 333). As a result, Ullmann (1985) argues that an organisation's strategic posture describes the mode of response of the organisation's key decision makers towards social demands. Therefore, stakeholder theory sees the world from the perspective of management.

Despite an extension beyond the economic and an acknowledgement of power relationships between the corporation and its stakeholders, Gray *et al.* (1997) argue that stakeholder theory is flawed because stakeholder theory focuses on the way the corporation manages its stakeholders. The corporation identifies the stakeholders that it will consider, and the level of attention it will give to each is based on how those stakeholders can benefit the organisation. According to Gray *et al.* (1997), stakeholder theory is essentially a market forces approach in which resources and the provision/withdrawal of those resources determine the type of the voluntary social disclosures at a given point in time. In addition, they argue that the organisation centred legitimacy on which stakeholder theory is reliant ignores important influences of society as a whole on the organisations' provision of information. These include the existence of statute law and regulations developed by government and statutory bodies, which contain requirements for information disclosure (Gray *et al.*, 1997).

The voluntary disclosure literature is interlinked with the literature on corporate governance and the literature on management incentives. Each of these literatures has endogeneity problems, and there is uncertainty and active debate on how to measure governance quality and how to measure incentives. Core (2001) reveals many contributions that can be made to the voluntary disclosure. A major contribution can be made to the voluntary disclosure literature by establishing how information asymmetry affects the cost of capital, and in particular determining whether information asymmetry affects expected returns. A second contribution can be made by creating more precise measures of the information asymmetry component of the cost of capital. A final contribution can be made by using computer technology to lower the cost of computing disclosure quality indices. These measures would add power to most disclosure-related research designs, as well as help address more general issues of fundamental interest to accounting researchers.

5. Legitimacy theory

Dowling and Pfeffer (1975) suggest that legitimacy theory is useful in analysing corporate behaviour. Because legitimacy is important to organisations, constraints imposed by social norms and values and reactions to such constraints provide a focus for analysing organisational behaviours taken with respect to the environment (Dowling and Pfeffer, 1975, p. 131). Gray *et al.* (1995b) argue that legitimacy theory and stakeholder theory should be seen as overlapping, as opposed to competing theories. They explain that both perspectives are set within the framework of PET. As the influence of society as a whole can affect the provision of financial and other resources to the firm, the firm utilises environmental performance and disclosure to justify or legitimise its activities to society (Gray *et al.*, 1995a, b). According to Deegan (2002), understanding motivations for disclosure is shown to be one of the issues attracting considerable research attention, and the desire to legitimise an organisation's operations is in turn shown to be one of the many possible motivations. He also discusses the role of legitimacy theory in explaining managers' decisions and emphasises that legitimacy theory must still be considered to be a relatively under-developed theory of managerial behaviour. Nevertheless, he argues that legitimacy theory provides useful insights. Deegan (2002) also indicates how the other researchers can contribute to the ongoing development of legitimacy theory in social and environmental reporting research.

Moreover, many authors have discussed corporate disclosure practices within the theoretical framework of legitimacy theory (e.g. Patten, 1992; Tilt, 1994; Wilmshurst and Frost, 2000; Deegan, 2002). Unlike stakeholder theory, which suggests that the corporation and its management acts and reports in accordance with the needs and power of its separate stakeholder groups, legitimacy theory focuses on the firm's interactions with society (Ullmann, 1985). Dowling and Pfeffer (1975, p. 122) provide a useful explanation of organisational legitimacy, thus:

> Organisations seek to establish congruence between the social values associated with or implied by their activities and the norms of acceptable behaviour in the larger social system of which they are a part. Insofar as these two value systems are congruent, we can speak of organisational legitimacy. When an actual or potential disparity exists between the two value systems, there will be a threat to organisational legitimacy.

Underlying legitimacy theory is the social contract that exists between the firm and the society within which that firm operates and consumes resources. Shocker and Sethi (1974, p. 67) provide a regularly quoted explanation of the concept of social contract:

> Any social institution and business with no exception operates in society via a social contract, expressed or implied, whereby its survival and growth are based on the delivery of some social desirable ends to society in general; and the distribution of economic, social, or political benefits of groups from which it derives its power.

In a dynamic society, neither the sources of institutional power nor the needs for its services are permanent. Therefore, an institution must constantly meet the twin tests of legitimacy and relevance by demonstrating that society requires its services and that the groups benefiting from its rewards have society approval (Lopes and Rodrigues, 2007). Deegan *et al.* (2000) describe the explicit terms of the social contract as legal requirements, whereas the implicit terms are un-codified community expectations. Even though the law is often reflective of societal norms and values, the legal system may be slow in adapting to changes in norms and values in society. Furthermore, the legal system is based on consistency whereas norms may be contradictory. And finally, it is suggested that society may tolerate certain behaviours but not be willing to codify those behaviours in the legal system (Dowling and Pfeffer, 1975; Deegan, 2002).

Where a difference exists between the values of the corporation, and the values of the community, corporate legitimacy is threatened (Lindblom, 1994). This disparity between the entity values and those of society is referred to as the legitimacy gap and may affect the corporation's ability to continue its operations. As Wartick and Mahon (1994) suggest:

> Legitimacy gaps may occur when: There is a change in corporate performance, but society expectations of corporate performance remains unchanged; Corporate performance is unchanged, but society expectations of corporate performance have changed; and Corporate performance and society expectations change in different directions, or in the same direction but with differing momentum.

However, it may be argued that the existence of and size of the legitimacy gap may not always be easy to determine (Wartick and Mahon, 1994). Furthermore, O'Donovan (2002) suggests that where a disparity exists between the expectations of the corporation and those of its relevant publics the corporation will need to evaluate its social values and then align them with those held by the society in which it operates. Alternatively, the corporation may attempt to alter the existing social values or perceptions of the corporation as a legitimating tactic. In order to close the legitimacy gap, the entity must identify those activities that are within its control and identify the relevant publics that have the power to provide the entity with legitimacy (Neu *et al.*, 1998; Bushman and Landsman, 2010).

The imprecise distinction between legitimacy, stakeholder and PETs should continue to be examined and explained. Care should also be taken in generalising too much from the results of these studies (O'Donovan, 2002). On a regular basis, individual corporations have different characteristics pertaining to their social and environmental goals; perceptions of the importance of social and environmental goals to their conferring publics; and other external pressures on them at any point in time. These perceptions and pressures will also change over time. It is posited that these different characteristics, goals, perceptions and external pressures, which may often be unrelated to an environmental issue/event at the time the issue/event is at its peak importance, will influence the decision to disclose environmental information and the choice of specific annual report disclosure approaches. Moreover, in many corporate disclosure studies using legitimacy theory, the annual report is identified as being the major way corporations communicated social and environmental information to various stakeholders (O'Donovan, 2002; Deegan, 2002; Lopes and Rodrigues, 2007).

Prior corporate social disclosure studies using legitimacy theory as the theoretical framework argue that the use of legitimacy theory as a valid theoretical framework for examining and explaining variations in disclosures practices can be extended to cover additional areas and issues than what it has currently been applied to within the extant literature (e.g. see Patten, 1992; Adams *et al.*, 1998; Brown and Deegan, 1999; O'Donovan, 2002).

While there are some similarities, the three alternative corporate disclosure theories (PAT, legitimacy theory and stakeholder theory) essentially differ based on fundamental assumptions. Unlike the political costs hypothesis of PAT, legitimacy theory and stakeholder theory make no assumption of rational, wealth-maximising individuals operating within the environment of efficient capital markets (Campbell, 2000; Deegan, 2002).

On the other hand, Woodward *et al.* (1996) have shown that both legitimacy theory and stakeholder theory consider an organisation to be part of the wider social system; legitimacy theory looks at society as a whole, whereas stakeholder theory recognises that some groups within the society are more powerful than other groups. Therefore, it is postulated that the alternative theories, which are of value in studies of corporate disclosure policies, focus upon distinct perspectives of the same issue. Through the dissimilar assumptions made and standpoints adopted, they paint the picture in different shades, which offer alternative insights into the subject matter (Woodward *et al.*, 1996; Bushman and Landsman, 2010).

6. Contingency theory

Contingency theory was originally developed as a means of explaining observed differences in the structure of organisations (Chapman, 1997). It suggests there is no unique best way of structuring an organisation under all circumstances. Thus a variety of contingencies will constitute the conditions appropriate to a particular type of organisation structure (Chenhall and Chapman, 2006). Early research of this type suggests that environmental conditions, for instance, technological uncertainty (Burns and Stalker, 1994) and the technology employed by the firm, e.g. type of production system, were key contingent variables (Woodward, 1981). Furthermore, it was suggested that contingencies are corporate strategy adopted and market environment (e.g. see Chandler, 1996; Chapman, 1997; Donaldson, 2001).

Schweikart (1985) observes that there is significant concern evident in the international accounting literature relating to issues such as harmonisation and differences in the accounting information presented across countries, as well as what he described as the "suggestion" that accounting information needs in different countries are subject to environmental influences. Schweikart's (1985) observation that there had been little empirical work conducted to support the concept of environmental influences on accounting is no longer a valid one, as there are many researchers using a contingency theory as a vehicle to establish a theory of international accounting (e.g. see Cooke and Wallace, 1990; Adhikari and Tondkar, 1992; Doupnik and Salter, 1995; Salter, 1998).

In its simplest form, contingency theory contends that what constitutes effective management is situational, depending upon the unique characteristics of each circumstance. Hicks and Gullett (1981, pp. 625-626) summarise the contingency view of organisations, as:

> […] the best solution is the one that is most responsive to the characteristics of the unique situation being faced.

Lawrence and Lorsch (1967) establish that the determinants of effective internal organisational processes are dependent (or contingent) upon variations in the environment in which the organisation operates. In their words: "These outside contingencies can be treated as both constraints and opportunities that influence the internal structure and processes of the organization" (Lawrence and Lorsch, 1967, p. 186).

Financial reporting and disclosure practices can be viewed as the outcome of an internal decision process of an entity. Thus, a simple extension of Lawrence and Lorsch's (1967) conclusion suggests it is possible to view the choice of accounting and disclosure practices as the result of an internal process, which is influenced by outside contingencies. This suggests that variations in the environment in which companies operate, such as those associated with differences in corporate nationality, will lead to differing decisions as to the optimal methods of corporate reporting and levels of disclosure (Lopes and Rodrigues, 2007).

Williams (2004) suggests that technologies and environments are the major sources of uncertainty for organisations, and that differences in those dimensions will result in differences in organisations. Thompson (1967, p. 68) suggests that organisations generally find such constraints "located in geographic space or in the social composition of their task environments". While the methods suggested by Thompson to characterise or measure these dimensions are not particularly useful in the accounting context, the general observation that environmental factors have both a physical or vocational dimension, as well as a social dimension, provides an important perspective as to the breadth of the environmental factors potentially affecting accounting and disclosure decisions.

Whereas, the roots of contingency theory are in the management and organisational theory literature, application of the theory to accounting and in particular to the area of management accounting, followed quite quickly. Hayes's (1977) work on organisational sub-unit performance assessment, in which much of his model development is based on the work of Thompson (1967), represents one of the early efforts at applying a contingency approach to management accounting. The use of contingency theory in management accounting research has continued and developed (for review, see Otley, 1980; Chapman, 1997; Chenhall and Chapman, 2006).

The application of contingency theory in financial accounting research is a more recent development. Thomas (1986) applies contingency theory to examine corporate reporting. He suggests that adopting a contingency perspective captures the idea that reporting practices are associated with what he refers to as particular circumstantial variables (Thomas, 1986, p. 254). Moreover, he conceptualises the constraints upon entities affecting management's choice of reporting practices as falling into two major classes, namely the environment of the enterprise; and its organisational attributes (Thomas, 1986, p. 254).

Therefore, contingent factors are argued to be both internal and external to the organisation. In the context of corporate reporting, Thomas (1986, pp. 256-257) contends that "Contingency theory postulates the existence of similar associations but asserts management's preferences with regard to reporting practices are related to the nature of environmental and organisational constraints rather than their relative income effects". While recognising that contingency theory is not without its limitations, both as a general theoretical model and in the context of its application to examining corporate reporting practices, Thomas (1986) suggests that it can still provide valuable insights, particularly in relation to the political and economic aspects of the process of accounting standard setting. According to Thomas (1986), these would include a consideration of the process by which adaptation to contingencies is brought about, the role of informal structures and the network of social relations and the possibility of reciprocal causality. A strong case is therefore established for the application of contingency theory to the examination of those factors affecting financial reporting practices (Lopes and Rodrigues, 2007).

Perhaps one of the most significant aspects of Thomas's (1986) study is his recognition that a significant body of research in comparative international accounting conducted up to the mid-1980s adopted, all be it implicitly, a contingency approach. He states:

> Although only rarely explicitly articulated, the conceptual framework underlying such research is essentially a contingency approach. Most studies take the form of either testing for differences between certain reporting practices in various countries, or the grouping of national accounting systems into relatively homogeneous subunits; in both cases the results are usually attributed to differences or similarities in social, political, or economic factors (Thomas, 1986, p. 255).

As a result, there is an implicit underlying theory that the reporting practices of each country are contingent on certain social, political and/or economic variables. This implicit adoption of a contingency framework continues to be common in the comparative international accounting literature. Thomas's (1986, p. 255) suggests that an indication of the more general applicability of contingency theory is provided by the current, and still continuing, debate regarding "the universal applicability of International Accounting Standards". The framework has also been explicitly adopted in some studies of international accounting practices. More recent examples include Eddie (1994) and Tan and Tower (1999). The latter study adopts a conceptual schema based on Thomas (1986, 1991).

Belkaoui (1983, p. 216) is one of the early writers addressing the influence of environmental factors upon accounting to acknowledge explicitly that such an approach adopts contingency theory as its basis. He recognises the need to look for the relations between measures of accounting development and adequacy on one hand and measures of political, civil and economic development and adequacy as a first step in the formulation of a contingency theory of international accounting. Schweikart (1985) is another early writer to explicitly recognise the application of contingency theory as a framework for international accounting research. In the context of international accounting, Schweikart (1985, p. 92) suggests "national environmental differences represent both external and internal contingencies on accounting information needs', and based upon comparative management research". Schweikart (1985) identifies likely environmental variables for a contingency model as falling into the categories of: educational, economic, political-legal and social (socio-cultural).

Three of these four categories, economic, political and social, are also those identified by Thomas (1986) as characterising the environmental variables suggested in comparative international accounting studies as influencing accounting practices. Schweikart (1985, p. 97) claims that this model can be used to explain differences in accounting policies among nations with different national business environments' (for a review, Figure 1). He indicates that the issue is one of "isolating the environmental variables affecting information needs, since contingency theory implies that information needs should vary with variations in the favorability or certainty of the decision environment" (Schweikart, 1985, p. 97). He also recognizes that applying such a model in an international financial accounting context poses a number of difficulties, since it is not possible to hold institutions and information constant across countries (Schweikart, 1985). Furthermore, the decision problems faced by users may not be uniform across countries. Schweikart (1985) suggests the following as a means of minimising the impact of these difficulties:

> Comparative research using nations with very similar accounting methods, institutions, and decision problems may be the only vehicle available to extract many significant environmental variables. This research design implies that the environments in such countries will have a high degree of similarity, but that subtle differences may be more reliable predictors of information-relevance predictors (Schweikart, 1985, p. 97).

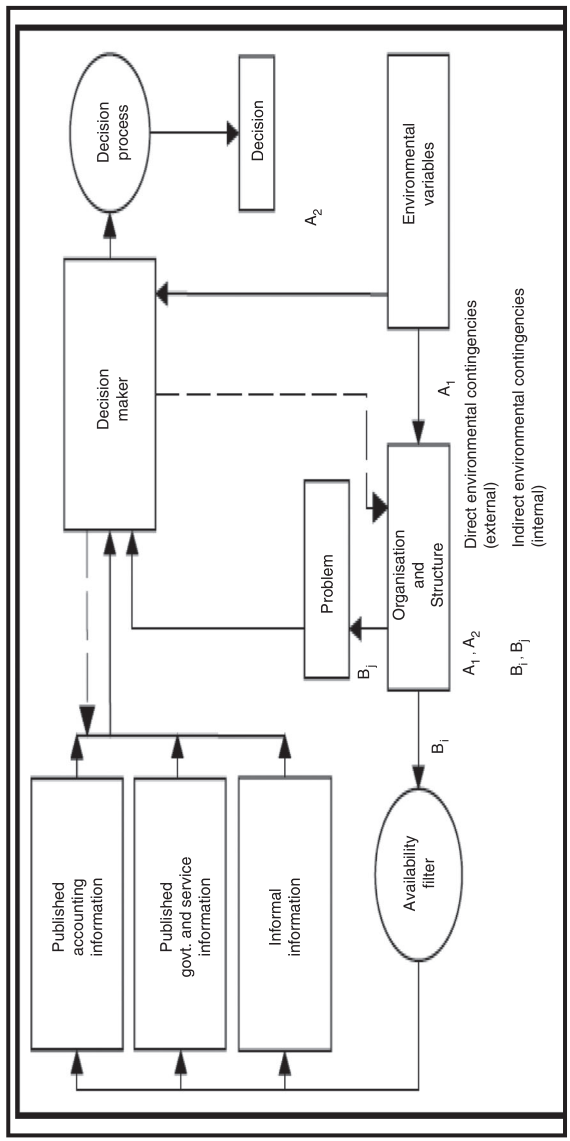
Consequently, this provides a clear direction for future research, suggesting concentration on smaller regional groupings of countries may provide more fruitful results than larger global studies. Thomas (1991) develops further the application of contingency theory to corporate financial reporting systems, arguing management's choice of corporate financial reporting practices is contingent upon the differing constraints on entities, which he indicated fall into four possible classes. He justifies inclusion of societal variables in his general contingency model for financial reporting systems on the basis that the theoretical framework underlying research in comparative international accounting is essentially a contingency perspective, where the results are usually attributed to differences or similarities in social, political or economic factors. Thomas (1991, p. 42) characterises such variables as "those factors to which all enterprises within a particular country are subject and which vary between nations. Finally, he suggests that not only are financial reporting systems influenced by contingent variables, but also such systems in some cases will influence those variables. Further, there will be interrelationships between the classes of contingent variables (Thomas, 1991).

In discussing research methodologies in international accounting, the American Accounting Association (AAA) describes the contingency approach as:

> Being concerned with the association between accounting and its environment, it distinguishes between global contingency approaches to cross-national financial accounting research, of which it identifies three, and the arguably more comprehensive contextual contingency approach. Studies adopting a global approach are described as usually deterministic, unidirectional and implicitly assumed that accounting is the dependent variable (AAA, 1993, p. 9).

In the AAA (1993) model the requirement to meet national expectations is represented by the test of effectiveness within country, wherein extant accounting practices are compared with normative or actual expectations within a country. A failure to pass the test again requires that change or adaptation occur, in this case either as changes in environmental factors, to align them more closely with extant accounting practices, or as changes in the accounting practices to meet actual expectations. In either case the process, as in Schweikart's (1985) model, is depicted as a feedback loop to the parties concerned with production of accounting information within the country (see Figure 1).

A significant contribution of the AAA (1993) model is the explicit introduction of a second test, to be performed when the "within country" test is satisfied, referred to as



Source: Schweikart (1985, p. 96)

Figure 1.
Financial Accounting Contingency Model

the "Global fit test". As indicated in the model, the global fit test involves comparison of accounting practices within the country under examination with "foreign profiles" of accounting practices. These "profiles" may comprise the accounting and disclosure practices of foreign companies, or the preferred practices as promulgated by an international accounting standard setting organisation, such as the IASB. Once again, this comparison is performed with the purpose of allowing feedback to those domestic organisations, professional bodies and individuals concerned with preparation of accounting reports within the country in question.

The importance of incorporating such a test in a contingency model cannot be understated given the current interest in the issue of harmonisation of international accounting practices. In this context, such a test would involve the comparison of companies' actual accounting and disclosure practices with those required by international accounting standards, possibly using indexes or similar measures of harmonisation to determine the extent of "global fit". Such tests clearly can and should incorporate examination of accounting practices in more than one country (for a review, see Figure 2).

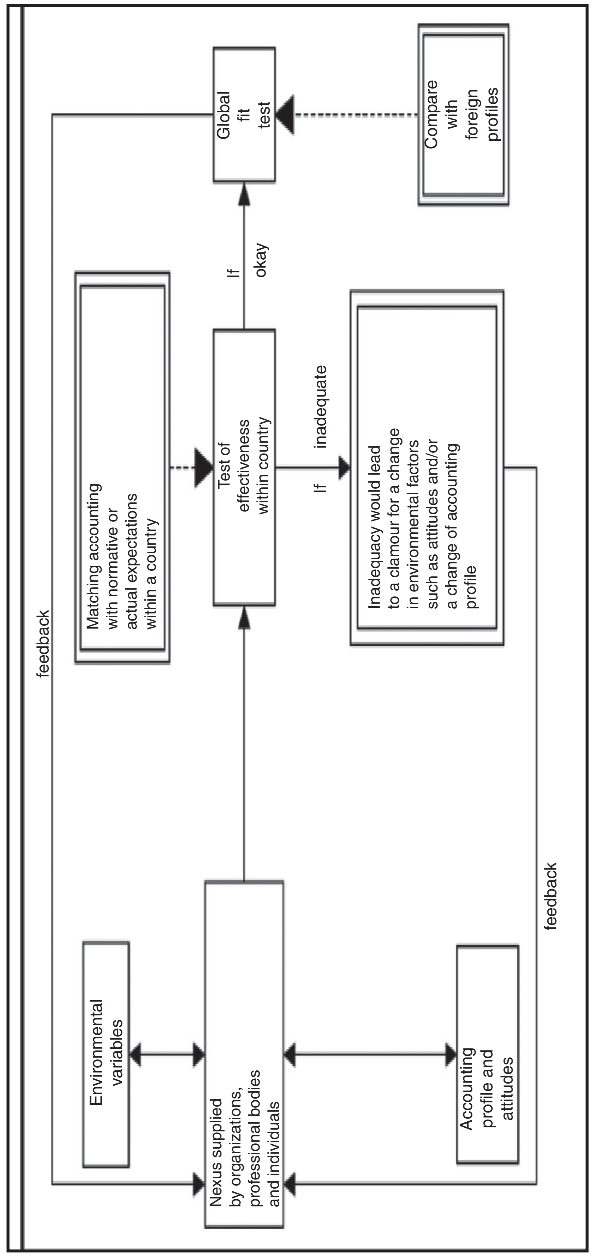
Based on the foregoing analysis of theoretical developments in the application of contingency theory to comparative international accounting research, and the need for such models to more clearly specify the nature of the environmental influences impacting on accounting development, an extended contingency theory of accounting disclosure is proposed. First, Gernon and Wallace's (1995) accounting environment and its various components replace two parts of the AAA (1993) model. This modification is required to avoid overlap, and to integrate the two models; the AAA (1993) contingency model separates the influence of formal accounting requirements, such as those contained in national accounting standards and regulations, from the other environmental variables affecting accounting disclosure practices (for a review, see Figure 3).

A further modification is the explicit inclusion of annual reports, reflecting the measurement and disclosure practices adopted by companies, as the output of the process. This modification provides more specific focus to this part of the model. These reports result from the bringing together of accounting with its environment, part of which is reflected in the nexus supplied by various entities, including companies as reporting entities, professional bodies and individuals. Their societal environment, with variables sub-classified as detailed above, elaborates the environmental variables in the extended model. Further, the foreign profiles forming the basis of the global fit test have been explicitly specified as comprising foreign companies' reporting practices and/or the requirements of the IASB.

Gernon and Wallace's (1995) and the AAA (1993) provide in combination a richer and more complete theoretical basis for examination of the environmental factors influencing the accounting disclosure practices (see Figure 3). The need for such a broad approach is suggested by Gernon and Wallace's (1995, p. 75) observation that whilst a significant amount of empirical research on the relationship between accounting and its environment has been carried out since the early 1970s, "results have, however, been inconsistent". Gernon and Wallace's (1995) recognise that:

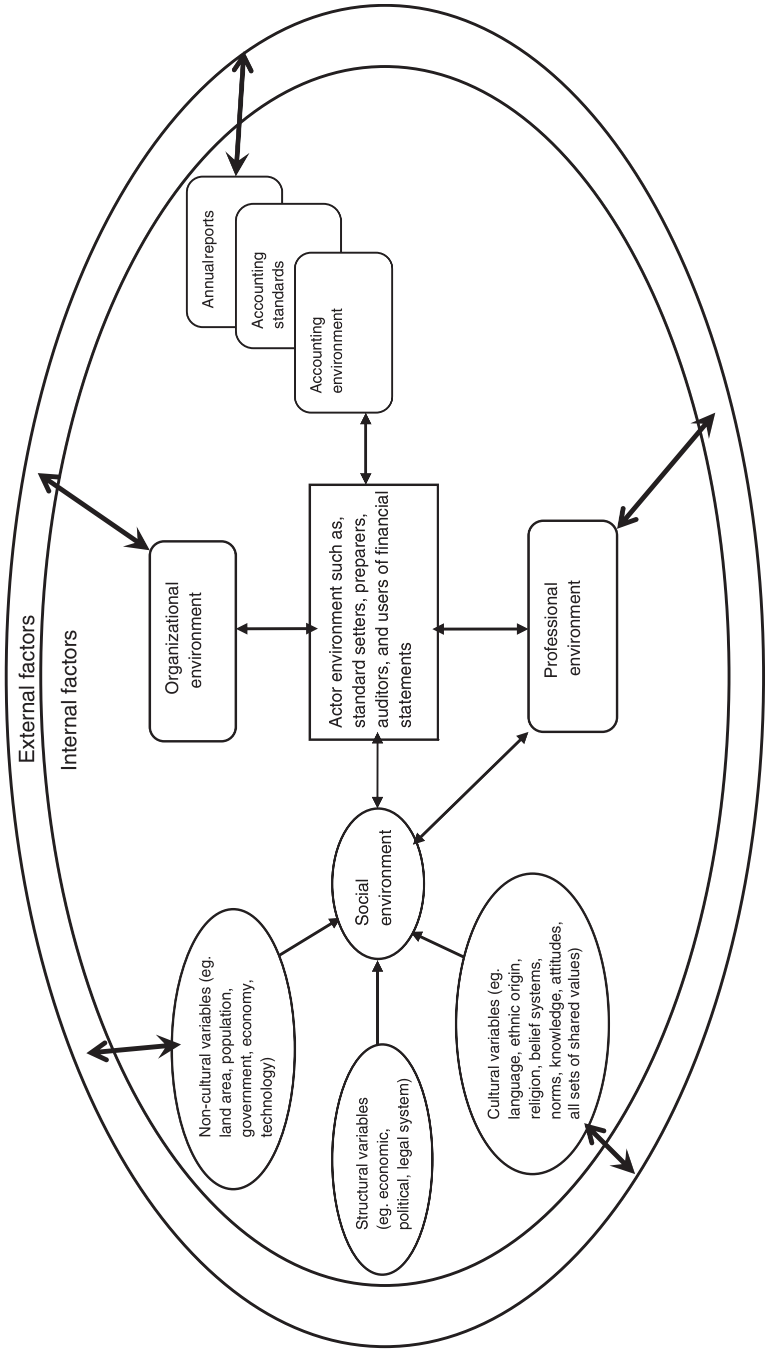
> The need for mutual recognition of mutual economic problems is a reason for formation of regional groups of countries, which they argue offer accounting scholars self-selected samples of countries for cross-national study of the diffusion of accounting (p. 74).

This is consistent with the view of Schweikart (1985, p. 97) noted earlier that concentration on smaller regional groupings, where countries' environments have a



Source: AAA (1993, p. 19)

Figure 2.
Contextual Contingency Approach to Cross-national Financial Accounting Research Model



Source: Gernon and Wallace (1995, p. 61)

Figure 3.
Accounting ecology

relatively high degree of similarity, is likely to be more fruitful since slight differences in environments are likely to be highlighted. A significant amount of research of this type has been carried out, concentrating almost exclusively on countries in the European Union, formerly the European Community. Countries in the South-East Asian region, such as Indonesia, Malaysia, the Philippines and Thailand, are a further instance of such a grouping which could form the basis of future research (for a review, see Emenyonu and Gray, 1992, 1996; Van der Tas, 1992; Archer *et al.*, 1995, 1996; Krisement, 1997; Lopes and Rodrigues, 2007). In terms of the current state of research into those factors, which affect the accounting disclosure practices, perhaps Gernon and Wallace (1995, p. 76) sum up the situation best when they state "more empirical work is needed to test the theory that accounting is a function of its environment".

7. Conclusion and future research

This paper extensively reviews the theoretical perspectives used in the accounting disclosure literature. It illuminates the literature of theoretical perspectives used to explain the accounting disclosure practices including PAT, agency theory, signalling theory, PETs, stakeholder theory, legitimacy theory and contingency theory. PAT is based on the wealth maximisation and individual self-interest concepts underlying economic theory. It seems that it is probably used when a corporation believes that its primary responsibility is to use its resources and engage in activities designed to maximise its profits. Financial accounting could continue to use quantitative methods in a positive accounting framework (Sharma, 2013). As Gaffikin (2007), there are technical difficulties such as how to interpret the evidence (Healy and Palepu, 2001). There are methodological inconsistencies and misunderstanding (Christenson, 1983). There are question of the sociological assumptions (economic rationality). However, despite all these problems this new research continues to dominate the academic accounting world at the expense of alternatives making accounting different from other closely associated disciplines.

Agency theory does not provide a detailed explanation of the available accounting choices (measurement methods and disclosure options). PAT (Watts and Zimmerman, 1978, 1986) yields a better explanation of accounting choices that managers can use to opportunistically report accounting information by triangulating the bonus plan, debt-equity hypothesis and political cost hypothesis. These assumptions of PAT have been challenged by many researchers (Tinker *et al.*, 1982; Christenson, 1983; Whittington, 1987). There is also a lively debate as to whether PAT is a proper theory or merely a research method. One argument is that it is a research method which is scientific and positivist (Gaffikin, 2008). As a scientific research method, this theory is typically used by mainstream accounting researchers for testing hypotheses and developing statistical models based on large data samples in order to explain the relationships of accounting (earnings) manipulation and some selected factors (e.g. managerial incentives or entity characteristics). A limitation is that the statistical models based on PAT cannot be used to interpret the circumstances of accounting manipulation or earnings management in individual cases. As a consequence, this theory cannot provide an all-inclusive (holistic), interpretive (social-constructive) explanation of accounting phenomena (Mouck, 2004). Although both positive accounting theory and agency theory have similar origins and explain managerial opportunism, neither can adequately explain how corporate managers, after misstating accounting numbers, engage in ex-post attitudinal and behavioural rationalisation. It is also argued that positivist accounting research evolved relying upon industry sponsorships, and is well recognised by top-ranked academic journals (Mouck, 2004; Parker, 2005; Gaffikin, 2008). Owing to such industry capture, positivist theory-based accounting research may be unable to holistically explain managerial opportunism and managers' behaviour as co-determinants of accounting manipulation. The review of literature also highlights industry sponsorships and the dominant presence of corporate executive/managers in the standard-setting process (Schneider, 2003; Brown, 2006; Cortese *et al.*, 2009).

Although the signalling theory is originally developed to clarify the information asymmetry in the labour market (Spence, 1973), it has been used to explain voluntary disclosure in corporate reporting (Ross, 1977). As a result of the information asymmetry problem, companies signal certain information to investors to show that they are better than other companies in the market for the purpose of attracting investments and enhancing a favourable reputation (Verrecchia, 1983). Voluntary disclosure is one of the signaling means, where companies would disclose more information than the mandatory ones required by laws and regulations in order to signal that they are better (Campbell *et al.*, 2001). While the use of signalling theory has gained momentum in recent years, its central tenets have become blurred as it has been applied to organisational concerns (Thornburg and Roberts, 2008). Connelly *et al.* (2011), provide a concise synthesis of the theory and its key concepts, review its use in the management literature, and put forward directions for future research that will encourage scholars to use signalling theory in new ways and to develop more complex formulations and nuanced variations of the theory.

On the other hand, PET does not focus only on the economic self-interest and wealth maximisation of the corporation, but also on the political, social and environmental aspects of a corporation. This theory seems to better explain why some corporations appear to respond to government or public pressure for information about their social impact. Agency theory provides the required framework to evaluate accounting choices and disclosure decisions in market-based studies.

The political connections of executives and associated corporate sponsorships of US political parties are well documented in Jennings (2003) and Thornburg and Roberts (2008). There are instances of companies being able to alter some accounting standard requirements (for a review, see Zeff, 2002; Brackney and Witmer, 2005; Farber *et al.*, 2007). Although the PET of accounting regulation reveals how managers' mind-set can bias the standard-setting and adaptation processes, this theory cannot satisfactorily explain the impact of internal governance and external oversight factors upon financial reporting practices.

Further research may be conducted here to provide evidence regarding the situation most suits each of these two theories. It may suggest that PAT is widely used in private corporations working in developing countries, whereas the concern is focused on maximising the private profit, regardless the social and environment aspects, while PET is commonly used in private corporations working in developed countries, whereas several social and environmental groups practice pressure on corporations for the social and environmental disclosure.

In addition, the paper discussed the "stakeholder theory" via the "legitimacy theory". Both of them consider an organisation to be part of the wider social system. However, while the legitimacy theory looks at society as a whole, the stakeholder theory recognises some selective groups within the society to be more powerful than others. Specialty fields like social responsibility accounting, intellectual capital and environmental disclosure studies fit well into the legitimacy theory and stakeholder's theory (Sharma, 2013).

Since the legitimacy theory is based on the society's perception, management is forced to disclose information that would change the external users' opinion about their company (Cormier and Gordon, 2001; Linthicum *et al.*, 2010). The annual report has been detected as an important source of legitimation (Dyball, 1998; O'Donovan, 2002). Legitimisation can occur both through mandatory disclosures – disclosures provided in financial statements because of regulations, and voluntary disclosures provided in other sections of the annual report (Magness, 2006; Lightstone and Driscoll, 2008; Thornburg and Roberts, 2008; Shehata, 2014).

Further research may be conducted here to highlight the situations most suit each of these two theories. It seems that the legitimacy theory is most suitable for multinational corporations working in developed/democratic countries; whereas the annual report is seen as the major way such corporations communicate social and environmental information with the society as a whole. On the contrary, the stakeholder theory seems to be most suitable for multinational corporations working in developing/dictator countries; whereas the corporation can manage its stakeholders, i.e. selects the powerful stakeholders that it want, and the actions that it will take to achieve the desired relationship with those stakeholders (Bushman and Landsman, 2010). According to Core (2001), many contributions can be made to the voluntary disclosure by establishing how information asymmetry affects the cost of capital, and in particular determining whether information asymmetry affects expected returns, creating more precise measures of the information asymmetry component of the cost of capital, and using computer technology to lower the cost of computing disclosure quality indices. These measures would add power to most disclosure-related research designs, as well as help address more general issues of fundamental interest to accounting researchers (Thornburg and Roberts, 2008).

Finally, the paper discussed the contingency theory and its relation with the accounting, disclosure practices and management accounting. It asserts that management's preferences of reporting practices are related to the nature of environmental and organisational constraints rather than their relative income effects. Further research may be conducted here to highlight the social, political and/or economic variables the reporting practices of Gulf countries are contingent on. According to Sharma (2013), management accountants and other emerging fields in accounting use interpretive view of accounting and engage in qualitative research using contingency theory.

Factors affecting the provision of and need for voluntary disclosure have been assembled by Healy and Palepu (2001) and Graham *et al.* (2005). According to Shehata (2014), the previous studies categorise the factors affecting managers' decisions to voluntarily disclose information among motivations and constraints. Motivations to voluntary disclosure include capital markets transactions/information asymmetry, corporate control contest, stock compensation, increased analyst coverage, management talent signalling and limitations of mandatory disclosure. Constraints on voluntary disclosure comprise: disclosure precedent, proprietary costs, agency costs and political costs. Litigation cost can be viewed as a motive or constraint (Shehata, 2014).

The new era of corporate regulation has its origins in the global financial crisis and a number of corporate collapses amidst allegations of accounting manipulation (Parker, 2005, 2008). Avenues for opportunistic financial reporting have persisted in this era in the presence of subjective judgments utilising accounting estimates (expected transactions) for depreciation, doubtful debts, inventory valuation and currency transactions and speculations (hypothetical transactions) for fair values and associated impairment under fair value accounting. Moreover, ethical dilemmas in corporations typically arise due to a chronic lack of ethical education. Therefore, this study suggest using interpretive (social-constructive) research approaches that consider subjective realities relating to framing a composite social-psychological analysis of accounting manipulation using sociological theories in combination with learning derived from the critical (re)appraisal of miscellaneous finance and political economy-based positive theories used in accounting literature.

Notes

1. The efficiency perspective is referred to as the *ex-ante* perspective (before the fact approach) which assumes that managers make accounting choices before contracting to present an efficient picture (economic reality) of the reporting entity (Healy and Palepu, 2001; Gaffikin, 2008). The opportunistic perspective is referred to as the ex-post perspective (after the fact approach) which considers that managers are self-utility maximizers, and hence they make accounting choices after contracts are in place (Deegan, 2013; Godfrey *et al.*, 2010).

2. This is the fact that US business schools were encouraged by industry groups and corporations to engage in more "business-oriented" research and to make greater use of the "underlying disciplines" (economics and finance). This call was backed up by resource support (more than $US30 million in grants). It is reasonable to infer that business wanted accounting research that supported business enterprise to justify their activities (Gaffikin, 2008, p. 66).

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